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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

FILED

PUBLIC UTILITIES

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In the Matter of the Application of)
PUBLIC UTILITIES COMMISSION	DOCKET NO. 2008-0274
Instituting a Proceeding to Investigate Implementing a Decoupling Mechanism for	
Hawaiian Electric Company, Inc., Hawaii	<u> </u>
Electric Light Company, Inc., and Maui)
Electric Company, Limited.)

DIVISION OF CONSUMER ADVOCACY'S

POST-HEARING OPENING BRIEF

AND

CERTIFICATE OF SERVICE

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DIVISION OF CONSUMER ADVOCACY'S POST-HEARING OPENING BRIEF

Pursuant to Schedule of Proceedings amended and restated by the Public Utilities Commission ("Commission") in the Order Approving, With Modifications, Stipulated Procedural Order Filed On December 26, 2008,¹ the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs, State of Hawaii ("Consumer Advocate"), hereby submits the following Post-Hearing Opening Brief ("Opening Brief") in the instant proceeding.

I. INTRODUCTION.

Through its Order filed on October 24, 2008, the Commission set in motion the current investigation into the feasibility of a decoupling mechanism to facilitate Hawaii's objective of transitioning to an energy industry with significantly more contributions from energy sources derived from renewable resources as well as greater reliance on energy

Subsequently, in a letter dated August 7, 2009, the Commission approved a motion, which, among other things, established the due date for opening briefs in the instant docket as September 8, 2009.

efficiency measures to reduce Hawaii's over-reliance on fossil fuels. Initially, there were eleven issues that were to guide the current investigation into the possible roles that decoupling might have in facilitating Hawaii's effort to wean itself from fossil fuels. Later, the issues were restated by the Commission in its letter dated June 25, 2009, wherein the Commission identified the issues for the Panel Hearings held in the instant docket. Those issues were as follows:

- 1. Will Decoupling Help Achieve Hawaii's Objectives?
- Decoupling Mechanics: How Well Does the HECO Companies'
 Decoupling Design Achieve Hawaii's Objectives?
- 3. Revenue Adjustment Mechanism: How Well Does it Achieve Hawaii's Objectives?
- 4. Revenue Per Customer Mechanism and Other Alternatives: How Well Do They Achieve Hawaii's Objectives?
- 5. Energy Cost Adjustment Clause Adjustment: What are Its Advantages and Disadvantages, In Terms of Hawaii's Objectives?
- 6. What Review Processes and Safeguards Should the Commission Consider?

Thus, the Consumer Advocate offers its opening brief within the outline of the above six issues. While not specifically stated as an issue, as the topic appears more than a few occasions within the above stated issues, it is important to properly recognize that the primary objective is to determine how decoupling, and which decoupling methodology, might best facilitate Hawaii's need to significantly reduce its reliance on fossil fuels by eliminating or mitigating utility concerns with the current

relationship between utility sales and income. As utility resistance has long been seen as a roadblock to greater progress towards Hawaii's efforts to become more energy independent, decoupling has been offered as a means by which to encourage electric utility companies to better align its business plans with the policy objectives of the State.

II. PROCEDURAL BACKGROUND.

- 1. On October 20, 2008, as a product of the Hawaii Clean Energy Initiative ("HCEI"), the Governor of the State of Hawaii, the State of Hawaii Department of Business, Economic Development and Tourism ("DBEDT"). the Consumer Advocate, and the Hawaiian Electric Company, Inc. ("HECO") Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO") (collectively, the "HECO Companies") entered into a comprehensive agreement ("Energy Agreement" or "HCEI Agreement") designed to move the State away from its dependence on imported fossil fuels for electricity and ground transportation, and toward "indigenously produced renewable energy and an ethic of energy efficiency."2
- 2. On October 24, 2008, the Commission issued its Order initiating an investigation to examine implementing a decoupling mechanism for the

Included in the Energy Agreement was a commitment by the HECO Companies to modify their traditional rate-making model by implementing a decoupling mechanism to separating the HECO Companies' revenues and profits from electricity sales.

- HECO Companies and ordered the Parties³ to file a joint proposal on decoupling that "addresses all of the factors identified in their Agreement."
- On December 3, 2008, the Commission issued its Order granting intervention motions filed by LOL, HREA, HDA, First Wind, DBEDT, HSEA, and Blue Planet.⁴
- 4. On January 6, 2009, the Commission issued its Protective Order in this Docket No. 2008-0274 to govern the classification, acquisition and use of confidential information by any party in this docket.
- 5. On January 21, 2009, the Commission approved, with modifications, the Stipulated Procedural Order filed by the Parties on December 26, 2008.
- 6. Also, on January 21, 2009, the Commission issued a letter to the Parties requesting comments and answers to questions provided within a scoping paper, titled "Decoupling Utility Profits from Sales: Design Issues and Options for the Hawaii Public Utilities Commission" developed by the Commission's consultant, the National Regulatory Research Institute ("NRRI").

As identified in its October 24, 2008 Order, and as later expanded by the parties allowed to intervene, the "Parties Consist of HECO Companies, Consumer Advocate, Life of the Land ("ŁOL"), Hawaii Renewable Energy Alliance ("HREA"), Haiku Design & Analysis ("HDA"), Hawaii Holdings, LLC dba First Wind Hawaii ("First Wind"), DBEDT, Hawaii Solar Energy Association ("HSEA"), and Blue Planet Foundation ("Blue Planet").

On November 17, 2008, Tawhiri Power LLC filed its Motions for Enlargement of Time to file its Motion to Intervene. The Commission did not find "excusable neglect" and did not grant Tawhiri Power LLC's intervention. The Commission denied Tawhiri Power LLC's Motion for Reconsideration on January 9, 2009.

- 7. On January 30, 2009, the Consumer Advocate submitted its HECO/MECO/HELCO Rate Adjustment Mechanism ("RAM") Conceptual Framework Proposal.
- 8. Also, on January 30, 2009, in accordance with the Order Approving, with Modifications, Stipulated Procedural Order Filed on December 26, 2008, issued by the Commission on January 21, 2009, the HECO Companies filed their Revenue Decoupling Proposal that was prepared with their consultant, Pacific Economics Group, LLC ("PEG").⁵
- On February 10, 2009, the Parties submitted their comments to the NRRI Scoping Paper.
- 10. On February 13, 2009, LOL filed its Notice of Withdrawal from the instant Docket No. 2008-0274. LOL's Notice of Withdrawal was approved by the Commission on February 24, 2009.
- On February 20, 2009, the Parties submitted their answers to Appendix 2
 of the Scoping Paper.
- 12. On March 5, 2009, the Commission issued its Information Requests ("IRs"), prepared by NRRI, to the Parties.
- 13. On March 30, 2009, the Parties submitted their Responses to Commission IRs and filed their respective Statements of Position. The Consumer Advocate and HECO Companies filed their Joint Proposal on Decoupling and Statement of Position.

On February 3, 2009, HECO Companies filed Corrections to HECO Companies' Revenue Decoupling Proposal.

- 14. During the period of April 6 15, 2009 the Parties exchanged IRs and Responses to IRs.
- 15. On April 29, 2009, the Commission approved First Wind's Motion for Approval to Amend Its Status from Intervenor to Participant.
- 16. On May 11, 2009, the Parties submitted their Final Statements of Position.
 The Consumer Advocate and HECO Companies filed a Joint Final Statement of Position ("Joint FSOP"). DBEDT filed their Final Statement of Position on May 12, 2009.
- 17. On June 5, 2009, the Commission issued a subsequent set of IRs, prepared by NRRI, to the Parties.
- 18. On June 9, 2009, HDA filed its Commission IR responses.
- On June 12, 2009, the Commission issued its Notice of Panel Hearing and Prehearing Conference.
- Subsequently, on June 16, 2009, the Commission issued its Order Establishing Hearing procedures.
- 21. During the period of June 18 June 29, the Parties submitted their responses to Commission IRs issued on June 5, 2009 and also submitted their list of hearing expert witnesses.
- 22. The Panel Hearings were held the week of June 29, 2009.
- 23. On July 1, 2009, the Commission issued its initial post-hearing set of questions. See PUC Hearing Exhibit 1.
- 24. On July 15, 2009, the Commission issued additional post-hearing IRs on the Parties.

- 25. On August 7, 2009, the Commission considered and approved the HECO Companies' request as provided in its July 31, 2009 letter and DBEDT's August 5, 2009 written request as Motions for Extension of Time which extended the time to file Opening Briefs to September 8, 2009.
- 26. On August 24, 2009, the Parties filed their respective responses to the Commission's Post-Hearing IRs.

III. DISCUSSION.

The Consumer Advocate supports the Commission's rigorous review and analysis of the decoupling proposals before it in this Docket. A complete record exists from which each of the identified issues set forth in the Commission's June 16, 2009 Order Establishing Hearing Procedures can now be resolved. For this reason, and given the general support for decoupling concepts among the Parties, the Consumer Advocate has elected to not restate all of the detailed provisions of its Joint FSOP with the HECO Companies or the many arguments for its approval, in the interest of submitting a truly "brief" document at this time. We understand, however, that HECO Companies may be planning substantive unilateral revisions to the Joint FSOP and we intend to respond to any such proposals in our Reply Brief.

The parties to this Docket all seem to recognize that decoupling, in some reasonable form, will be an important tool that can be used to advance the State's objectives in moving away from business as usual fossil-fuel-based generation of energy. It also appears that, with acceptable remedies to certain legitimate issues that have been raised by the parties, the Revenue Balancing Account ("RBA") proposal is

seen by the parties as the most reasonable approach to basic decoupling. On the second question of how best to replace traditional rate cases after the HECO Companies' revenues are "frozen" under decoupling, the Parties have more diverse views of how any Rate RAM should be structured and administered

Prior to the Panel Hearings, the Consumer Advocate recognized the need for changes in the Hawaii regulatory framework and had carefully considered alternative new approaches to the regulation of the HECO Companies. The need for such changes first became obvious last year when the HECO Companies agreed to bear an extraordinary scope of new efforts and costs to help achieve energy independence for the State, as memorialized in the HCEI Agreement. The HCEI commitments undertaken by the HECO Companies include substantial new commitments that are aimed primarily at ways to systematically reduce the traditional energy supplier role of the utility and its resulting energy sales volumes, through expanded wind and other "clean" energy technologies and through expanded energy efficiency measures. It was recognized by the HCEI Agreement signatories that the traditional regulatory framework would not allow the stated objectives to be met within the overall target deadline of the year 2030. No longer could sales growth between rate cases be used by the utility to "pay for" its increasing costs without needing frequent rate cases. This old regulatory framework worked historically to delay formal rate actions because of existing rate designs that provided recovery of utility fixed costs through volumetric rates - so that when sales increased, profits tended to increase.⁶ With this realization of changed circumstances and the expectations of displacement of future utility sales with

See Consumer Advocate's HECO/MECO/HELCO Rate Adjustment Mechanism"RAM" Conceptual Framework Proposal dated January 30, 2009 at page 4.

renewable and customer-sited resources, the HCEI Agreement provided in paragraph 28 for a new general framework of regulation involving decoupling and formulistic rate adjustments to spread out the need for future traditional rate cases.

The Consumer Advocate's work on decoupling continued into early 2009, as we tackled the challenging decoupling implementation issues within workshops with the other parties to this Docket, and in further negotiation sessions with the HECO Companies. The Consumer Advocate was assisted in its effort by its consultant, Utilitech, Inc., bringing that firm's considerable depth of experience with Hawaii regulation, involvement in all recent rate cases of the HECO Companies and experience with alternative regulation in other states to the process. Our work culminated in the proposed decoupling framework that is set forth in detail within the Joint FSOP.

The issues surrounding decoupling alone are complex and defy simple solutions, as evidenced by the breadth of discussions in the Panel Hearing. The Consumer Advocate's approach to the decoupling issues was guided by several important principles:

- Any decoupling mechanism should be <u>conservative</u> in design, while balancing the interests of ratepayers and shareholders in just and reasonable rates.
- Decoupling should employ <u>simple</u> and administratively workable methods, with filings and review procedures that can be efficiently reviewed and approved.
- Ratepayer <u>safeguards</u> must be designed into the decoupling mechanism,
 to provide additional assurance of just and reasonable rates.

The Joint Final Statement of Position of the HECO Companies and the Consumer Advocate ("Joint FSOP") sponsored by the HECO Companies and the Consumer Advocate in this Docket incorporates all of these principles. This Opening Brief will demonstrate why the RBA and RAM provisions set forth in the Joint FSOP should be approved at this time as the most complete regulatory response to the issues raised in this Docket.

A. WILL DECOUPLING HELP ACHIEVE HAWAII'S OBJECTIVES?

The Panel Hearing Moderator summarized Hawaii's regulatory objectives at the beginning of the panel hearings as including "two essential objectives...One is to reduce consumption of fossil fuel based electricity by substituting energy efficiency, demand response, and renewable energy. And the second major objective is to maintain the utility's' ability to cover its prudent fixed costs so that it can attract capital on reasonable terms sufficient to fill its statutory obligations."(Tr17). Three alternative ratemaking methods were identified in the hearings as candidates for consideration with these objectives in mind:

- Status quo reliance upon traditional rate cases and special clauses/surcharges.
- 2) Revenue decoupling plus RAM; per the Joint FSOP, or
- 3) The HDA Revenue Per Customer decoupling method.

As noted by the moderator, "The question for the hearing is which of these methods of revenue requirement recovery is most likely to achieve Hawaii's objectives." (Tr14). The answer to this question cannot be found in any absolute facts, because the ordered

outcome in this Docket can only be applied prospectively. Thus we are left with only informed judgment and with financial forecasts of expected outcomes that are inherently uncertain under normal conditions of economic stability and utility business as usual operations. Such forecasts are nearly impossible to accurately prepare in the midst of an economic recession that is one of the most severe in recent history while contemplating revolutionary changes in energy resources in the State.

No matter what is ordered by the Commission in this Docket, the HECO Companies will retain the legal right to file applications in the future for traditional rate changes under Hawaii Revised Statutes ("HRS") § 269-16. Traditional rate cases have been initiated historically by the HECO Companies whenever growth in its KWH sales and related revenues was not sufficient to offset increasing expenses or rate base growth. In periods of sustained sales growth and modest utility cost escalation, the HECO Companies has been able to go many years without a rate case. However, as soon as sales/revenue growth stops and costs continue to grow, the stage is set for recurring annual rate case filings. As evidenced by the signatories' willingness to support the HECI Agreement, there is a firm commitment to the objective of weaning Hawaii off of fossil fuel based generation. It is recognized that this transition will be a capital intensive process and that utility investment will potentially be significant. As Mr. Brosch testified, "the joint proposal is a reasonable balance for these companies at this time, built on the premise that we've turned the corner on historical sales trends and that is a likely signal that we'll be seeing back-to-back rate cases from these companies

The Consumer Advocate noted in its response to NRRI Scoping Paper Appendix 2 Question No. 1 that was filed on February 20, 2009 that the HECO Companies enjoyed strong sales and revenue growth from the mid 1990's until about 2005, but that these sales trends "have recently changed."

in the absence of some more creative approach to revenue requirements."(Tr.95) The HECO Companies sounded a similar theme in these excerpts from their response to PUC-IR-21:

A revenue decoupling mechanism plays an integral role in the HCEI Agreement for two fundamentally different reasons. One is the further slowdown in sales per customer growth that is expected to result from increased efforts to promote conservation and customer-sited DG. The second is to mitigate the increase in operating risk that may result from the agreement. In the short run, one source of greater risk is proposed increases in volumetric charges. In the longer run, the Company faces increased risk from greater reliance on renewable sources of energy.

....Annual rate cases for the Companies are an alternative means to obtain the needed revenue requirement escalation under a decoupling plan without RAM. This approach would involve a high level of regulatory cost at a time when the implementation of the HCEI agreement will be raising a host of new issues meriting regulatory oversight.

While annual rate cases may seem acceptable in spite of the tremendous costs and administrative burdens they impose upon Commission and Consumer Advocate resources, another problem is raised by maintaining the status quo form of regulation. The financial strength of the utility can be undermined by regulatory lag whenever costs are increasing more rapidly than they can be recovered through traditional rate case processes. The HECO Companies must continue to invest in replacement plant to maintain reliability of existing infrastructure, while also raising capital to fulfill the substantial obligations they have accepted under the HCEI Agreement. The HECO Companies' access to capital on reasonable terms is essential to the ability of the state to pursue the HCEI objectives. Noting a stated objective in this Docket, "... to maintain the utility's ability to cover its prudent fixed costs so that it can attract capital on reasonable terms sufficient to fill its statutory obligations," the Consumer Advocate submits that a conservatively designed RBA/RAM mechanism is a better solution than

continued frequent traditional rate cases during the implementation of the HCEI provisions.

B. DECOUPLING MECHANICS: HOW WELL DOES THE HECO COMPANIES' DECOUPLING DESIGN ACHIEVE HAWAII'S OBJECTIVES?

As an initial point of clarification, the "HECO Companies' Decoupling Design" is not before the Commission for approval in this Docket. Instead, the HECO Companies and the Consumer Advocate are supporting acceptance of a Joint FSOP that contains recommended provisions reflective of the many compromises reached between the Consumer Advocate and the HECO Companies. The HECO Companies' desired decoupling design was submitted on January 30, 2009 in this Docket and was vastly more complex and potentially rewarding to shareholders than is the RBA/RAM recommendation contained in the Joint FSOP. The Joint FSOP at Exhibit C Summary of Decoupling Proposal Agreement compares and summarizes the many changes made to the HECO Companies' initial proposal to reach agreement with the Consumer Advocate. The provisions of this Joint FSOP are designed to achieve Hawaii's objectives regarding just and reasonable rates, administrative simplicity and efficiency and protection of the financial health of the utilities as HCEI Agreement implementation occurs.

The proposed RBA, as described in the Joint FSOP, is the basic decoupling device that will ensure that the HECO Companies collect no more or less than the target

level of margin revenues⁸ that is found reasonable by the Commission in the most recent rate case or RAM calculation. It is an accepted fact that most of the utility's costs other than fuel and purchased energy are fixed in nature.⁹ When such fixed costs are recovered by a utility through energy or demand rate elements that produce lower revenues when sales volumes decline, the utility suffers from an inability to fully recover its costs. Decoupling is designed to periodically adjust rate levels to correct for changes in actual sales volumes (KWH and KW Demand), so that the intended level of revenues are earned by the utility at all times. Thus, decoupling ensures full recovery of the fixed cost levels established in the utility's last rate case, insulating the utility from all risks and opportunities arising from trends in actual sales between rate cases. The RBA proposal represents "full" decoupling on a true-up basis, by specifically tracking and comparing target versus actual sales revenues each month within a balancing account that would be reconciled annually (with interest) in filings made by each HECO Company.

With HCEI implementation, it is expected that conservation and customer-sited renewable DG will displace increasing amounts of the HECO Companies' fossil-generated energy. To protect against the pervasive erosion of its energy sales revenues and the continuous cycling of rate cases that would be required to otherwise provide full fixed cost recovery, the RBA will stabilize the HECO Companies' margin

Margin revenues are total electric sales revenues, reduced by fuel and purchased energy costs and any DSM/IRP, revenue tax or other surcharge revenues. Margin revenues are what is "left over" after variable costs are paid for the HECO Companies to use as fixed cost recovery.

In the Panel Hearings, the HECO Companies' witnesses testified that as much as 90% of HECO's costs are "fixed" costs (Tr. 19, 21). DBEDT's witness disputed these values, asserting that a much lower percentage of fixed costs are actually recovered through "variable" rates. (Tr. 131)

revenues. One benefit of revenue stabilization is the protection of the HECO Companies' financial condition and ability to access capital markets on reasonable terms. Another benefit from decoupling revenue stabilization is the reduction in business risks faced by the HECO Companies after sales volume risks are shifted to ratepayers, which serves to rationalize a lower authorized return on equity for the utility in future rate cases. Next, it should be noted that decoupling is beneficial in eliminating the need in rate cases to accurately predict future test year sales volumes and revenues, because any inaccuracies in such predictions are self-correcting through the RBA account. Finally, by making the HECO Companies indifferent to changes in future sales volumes, decoupling removes any perceived business disincentive to fully support the deployment of renewable resources, DG or expanded conservation measures. In all of these ways, revenue decoupling and the RBA provision serve to complement the State's objectives set forth in the HCEI Agreement.

Administrative efficiency and cost savings can be expected if decoupling is approved for the HECO Companies. These efficiency gains can be expected primarily as a result of less frequent general rate cases that tend to consume substantial resources and distract from other strategic initiatives before the Commission in connection with the HCEI provisions. the HECO Companies have indicated that its costs for recent rate cases, that were mostly settled rather than litigated, ranged from \$1.5 to \$2.3 million per case, before any consideration is given to the additional costs incurred by the Commission, Consumer Advocate and other intervenors. Much lower direct costs of the HECO Companies of less than \$100 thousand annually per utility are

HECO Companies' response to PUC-IR-23, Attachment 1.

predicted if RBA and RAM provisions are implemented, assuming some similarity to administration of existing Energy Cost Adjustment Clause ("ECAC") and DSM tariffs.¹¹

It should also be noted that all parties to this Docket are supportive of the basic decoupling concept and no party appears to be objecting to the proposed RBA provision in the Joint FSOP. Full decoupling of sales volumes from utility margin revenues is important to the goal of aligning utility incentives regarding sales volumes with the broader goals of the State to move away from fossil-fuel generated utility-supplied energy. Thus, it is apparent that the basic decoupling mechanism, as set forth in the RBA provision tariff and related administrative procedures documented within the Joint FSOP are entirely consistent with the State's objectives and should be approved.

On July 15, 2009, the Commission issued additional information requests including a question inquiring about any possible legal ramifications related to imposing a decoupling charge on customer categories that have reduced their consumption, while granting a decoupling credit to those customers who have increased their consumption. Notwithstanding the State's policy to induce a reduction in consumption, the Consumer Advocate is not aware of any express legal prohibition related to the application of decoupling charges and corresponding credits. Pursuant to HRS §269-16(b), the Commission may allow reasonable discrimination between localities or consumers under similar conditions. In the instant case, the overall State policy is preserved by this decoupling/RAM process and framework in that the broad encompassing intent of this

¹¹ Id. Attachment 2.

See Closing Statements Tr. 700-732. See also HDA Final SOP dated May 11 at pages 3-6 and DBEDT Final SOP dated May 11 at 8-19. DBEDT recommends modification of certain RAM terms and application of performance measures as a condition of RBA/RAM recovery.

process is to incentivize customer and utility participation in energy efficiency, demand response, and renewable energy while decreasing the impact and burden of frequent rate hikes that would be necessary to allow the utilities to recoup related lower revenue costs.

In the next section of this Brief, the RAM provision will be discussed.

C. REVENUE ADJUSTMENT MECHANISM: HOW WELL DOES IT ACHIEVE HAWAII'S OBJECTIVES?

The other element of decoupling recommended in the HECO Companies and Consumer Advocate's Joint FSOP is a RAM provision that would serve to replace annual rate cases with formula-driven estimates of utility revenue requirements. The RAM provision is needed in addition to RBA, because the RBA will serve only to hold utility margin revenues constant between rate cases, providing no opportunity for recovery of any increasing costs to provide service. This two-part approach to decoupling was explained by Mr. Brosch in the hearings as follows:

The decoupling proposal before the Commission is in two parts. There's a revenue balancing account proposal that, in isolation, would be piecemeal in the sense that it tracks only changes in margin recovery through sales. When coupled with the rate adjustment mechanism, we're building a second structure that is intended to simulate the changes in cost. RBA deals with changes in recovery. RAM deals with simulating changes in cost, and estimating what the revenue requirement would look like in the absence of a full-blown rate case. (Tr. 96)

The RAM provision will only prove to be beneficial to ratepayers if it succeeds in the intended, "simulating changes in cost" because any failure in this regard would lead either to the HECO Companies' abandonment of the mechanism by filing a rate case or to excessive earnings that would be subjected to an earnings sharing calculation each

year. In this regard, the detailed element of the RAM provision should be discussed so that these outcomes can be better understood.

The HECO Companies' revenue requirements are defined as the combined costs of operating and maintenance expenses, tax expenses, depreciation/amortization expenses and return on rate base investment. In every formal rate case that is initiated by one of the HECO Companies, each of these components of revenue requirements creates a need for one or more witnesses sponsoring the detailed, highly complex budget evidence that is developed across all departments on a decentralized basis. The proposed RAM provision **simplifies** this inherently complicated process in several ways, by

- Starting with PUC-approved expense levels from the latest rate case decision,
- 2) Utilizing available recorded plant investment balances and Commission-approved accrual rates in place of forecasts for calculation of depreciation/amortization expenses and to determine the front "half" of the average rate base,
- 3) Updating only the largest four elements of rate base; Plant in Service, Accumulated Depreciation, Accumulated Deferred Income Taxes, and Contributions in Aid of Construction,
- 4) Utilizing only two expense escalation indices from published third party sources for all labor and non-labor O&M expenses, and
- 5) Holding the authorized rate of return constant at the Commission-approved level.

Using these conventions, the annual RAM calculations for each utility require only a few pages of documentation and can be prepared and reviewed efficiently.¹³ The negotiated simplification of the RAM provision was one of the key factors to gaining Consumer Advocate support for the Joint FSOP.

In addition to simplification, the negotiated RAM provisions are intentionally conservative and are expected to impose cost management disciplined upon HECO Companies' management, while still providing a reasonable opportunity to recover inflationary increases in cost as well as increased capital investment so as to reduce the need for formal rate cases. Elements of conservatism are introduced by:

- 1) Labor expenses that are escalated by the percentage increases documented within each Company's union wage agreements, even if actual non-union wage increases are higher or include incentive compensation pay.
- 2) Escalated wage expenses are then reduced by an assumed labor productivity offset of 0.76 percent.¹⁴ This productivity offset forces the HECO Companies to find new technologies or business processes that enable it to do more work with fewer employees or reduced overtime hours in order to fully recover its future labor expenses.

See example RAM O&M and Rate Base calculations at FSOP Exhibit C, Attachments 1 and 2.

The 0.76 percent productivity offset as well as use of GDPPI as a non-labor expense price index was recommended by the HECO Companies in a Performance Based Regulation proposal made approximately 10 years ago. See HECO T-2 in Docket No. 99-0396. The Commission may wish to order the commencement of formal updated productivity studies for consideration in the review of the decoupling plan that is scheduled to occur as part of HECO's 2011 test year rate case.

- Non-labor expenses are escalated by the published Gross Domestic Product Price Index ("GDPPI"), which is reflective of national finished goods price trends rather than Hawaii inflation and that captures productivity gains achieved in the broader economy.
- 4) Only the four largest components of rate base are updated. Changes for Plant in Service growth are limited to average historical baseline plant additions (that are both easily verifiable and without escalation of prices) plus major projects that are completed by September 30 (limited to PUC approved total estimated costs).¹⁵

The combined effect of these RAM provision simplification and conservatism elements is intended to produce adequate revenue enhancement between formal rate cases to preserve the financial integrity of the HECO Companies in an administratively efficient manner (without annual rate cases). However, the resulting revenue changes are clearly derived from limited information and simplifying assumptions about how actual future utility costs trends correlate with RAM labor and non-labor indices - results that may prove to be inaccurate. With this in mind, the Joint FSOP provides for several consumer safeguards that are discussed in Section VII of this Opening Brief and that include an earnings reporting/sharing mechanism and a formal review of RAM and the Companies' HCEI performance in the scheduled HECO 2011 test year rate case.

As already pointed out in other sections in this Opening Brief, Hawaii's stated intention is to significantly increase the contribution from energy efficiency measures

These RAM terms are summarized in the RAM Provision Tariff and can be compared to initial positions taken by the HECO Companies and the Consumer Advocate in the "Agreement" column of Joint FSOP Exhibit C.

and energy from renewable sources to meet consumers' demand. In order for this to happen, the utility company must be able to readily access capital. The RBA will maintain the utility's margin, but the RAM is critical to ensuring that a utility's ability to attract capital for new projects is not unreasonably constrained.

The RAM provision will achieve Hawaii's objectives if it succeeds in reasonably estimating the HECO Companies' incremental revenue needs, so as to yield just and reasonable rates without the delay and cost associated with processing formal annual rate cases. Avoidance of regulatory lag and costs can be expected to improve the financial condition of the HECO Companies, thereby assisting in their ability to perform the many undertakings expected of them within the HCEI Agreement. If RAM revenue changes are insufficient, the Company can be expected to abandon the mechanism in favor of formal rate cases that would be more compensatory but less timely than RAM. On the other hand, if RAM revenue changes prove in the future to be excessive, the HECO Companies will be temporarily rewarded with a retained share of the resulting higher earnings, but only until the next scheduled rate case when cost reductions can be "captured" for ratepayers in the new revenue requirement and any future RAM provisions can be re-calibrated to improve accuracy. 16

Alternatively, if RAM fails to replace formal rate cases, the Commission may determine the RAM provision to not be worth retaining as part of the regulatory framework, instead of re-calibrating the inputs and continuing the RAM.

D. REVENUE PER CUSTOMER MECHANISM AND OTHER ALTERNATIVES: HOW WELL DO THEY ACHIEVE HAWAII'S OBJECTIVES?

1) Revenue Per Customer Freeze.

In its Final Statement of Position, HDA supported the RBA decoupling mechanism proposed in the Joint FSOP of the HECO Companies and the Consumer Advocate, providing that problems with the ECAC mechanism were addressed. However, HDA presented and supported Commission consideration of a "revenue per customer" or ("RPC") approach to what it called "recoupling" as an "alternative to the HECO Companies' proposed RAM."17 As stated by HDA, "The RPC index is designed to allow recovery of test year fixed costs to grow in proportion with utility system growth using an index of the number of new customers as a proxy for utility system growth between rate cases." 18 HDA proposed that this customer growth index not be applied to the largest HECO Companies' customers taking service on Schedules PT, PP and PS, arguing that these classes are already essentially decoupled by way of marginal revenues being approximately the same as marginal energy delivery costs, noting also that "it is difficult to effectively apply an RPC index to Schedule P customers in any case since the average size of customers is large, quite variable and the number of customers is relatively small."19

The HECO Companies responded to the HDA alternative method in hearings, noting that the Revenue Per Customer method, "...doesn't do as good a job as our

HDA Final Statement of Position, May 11, 2009, pages 4 and 6-19.

¹⁸ Id. p.17.

¹⁹ ld. p.19.

proposed RAM in providing the relief for those anticipated expenses ... [because] revenue growth associated with new customers ...doesn't bear a particularly helpful relationship to [HECO's] expense increases."(Tr.450) The poor correlation between the HECO Companies' historical actual expenses and the number of customers can be observed in the HECO Companies' response to PUC-IR-46 Attachment 1. Utility expenses and rate base investment change as a result of many cost drivers beyond just the addition of new customers or the loss of existing customers, such as inflation impacts upon wages, contractor charges and materials and the need to replace and maintain existing infrastructure at relatively higher costs today than when the plant was initially installed. These cost drivers were explained by the HECO Companies in its response to PUC-IR-21.

Consumer Advocate witness Brosch also explained why a key assumption behind the RPC approach, that future utility costs will vary proportionately with the number of customers served, is unproven and unlikely to produce reasonable results:

MR. BROSCH:

Let me say that solving the decoupling problem, if we limit it to addressing the effective changes in sales to the changes in revenues that the utility recovers, that problem in isolation can be solved simply with a revenue balancing account approach. That approach would essentially say, we're going to do a rate case, we're going to establish a revenue requirement, and we're going to ensure that [the] utility collects that revenue requirement as we march forward in time.

That does nothing to address the question of, what if locked in fixed amounts of revenue contribution to the utility's cost is inadequate to recognize changes in those costs? And that's the second stage that RAM would address in the joint proposal.

My understanding of revenue per customer is that it attempts to address that second stage that, I'll call it,

attrition concern, with this assumption that the best measure of changes in total utility cost to serve is the number of customers being served. And it's that premise that I don't particularly appreciate or endorse.

The premise behind RPC is flawed. The revenue requirement of the HECO Companies is driven by many factors, only one of which is the modest direct cost incurred to connect a new customer. ²⁰ HDA has made no showing that RPC can be expected to produce reasonable results when applied to the HECO Companies or that the fundamental cost basis for the method is defensible. In fact, Mr. Freedman admitted in the hearing that, "I think it's true that the RPC methodology does not track fixed costs as well as the RAM mechanism."(Tr.448)

The Consumer Advocate views the RPC methodology as less likely to achieve the primary goal of the RAM, which is to conservatively, simply and accurately adjust the HECO Companies' authorized revenues between rate cases to recognize annual inflation indices, known wage rate changes and known additions to rate base. If this goal is not met, the HECO Companies can be expected to file frequent rate cases and the Commission may as well not approve any RAM-like mechanism. Furthermore, the costs associated with conducting multiple rate cases will take its toll on applicable stakeholders, such as the Commission and Consumer Advocate, and the resulting regulatory lag will adversely affect the successful completion of Hawaii's HCEI objectives. Considerable effort was devoted to development of a simple and administratively workable RAM to meet this goal and HDA has offered no rebuttal or criticism of the RAM.

Mr. Brosch explained that "only the investment in electric meter and service line investment and costs associated with reading meters and billing customers clearly are costs that vary in a pretty direct relationship with numbers of customers being served." (Tr.457)

2) Partial RAM Alternatives.

In Post-Hearing Information Requests issued by the Commission, the HECO Companies were asked to explain and quantify how certain alternative approaches to RAM can be expected to impact the Company and its ratepayers.²¹ The scenarios postulated by the Commission's consultant, NRRI, in these Information Requests included:

- Quarterly rate adjustments for return and depreciation on "net additions to the FERC accounts related to system reliability."
- Quarterly rate adjustments for return and depreciation on "net additions to the FERC accounts related to customer additions."
- Quarterly adjustments for the "difference in operating and maintenance costs associated with complying with Act 155, from those included in base rates."
- Only the O&M portion of the proposed RAM, without rate base adjustments.
- Combinations of the first, second and third (or fourth) elements listed above.

The HECO Companies' response to this request was instructive, not so much in terms of the revenue and financial results predicted by the HECO Companies' forecasting exercise, but in the HECO Companies' narrative describing how NARUC accounting rules do not accommodate the plant classifications being proposed by NRRI²² and the

PUC-IR-3 was renumbered by the HECO Companies as PUC-IR-52.

See also the HECO Companies' responses to PUC-IR-50 and PUC-IR-51.

extreme complexity and numerous simplifying assumptions required to interpret and apply the proposed new accounting criteria. The problem is that utility spending on new plant investment or O&M does not fall cleanly into categories such as "reliability" or "new customers" or "Act 155 compliance", requiring largely judgmental filtering and classification of potentially thousands of construction projects and O&M expenditures to comply with any prescribed ratemaking formula using these terms. As a consequence, the NRRI alternatives defining eligible RAM transactions lead to substantially increased complexity for the HECO Companies to develop and compile information not typically maintained in the normal course of business.

In its comments on these potential partial RAM variations, the Consumer Advocate explained why the proposed partial RAM variants were unlikely to achieve a balanced quantification of changing revenue requirement and would be administratively unworkable and likely to lead to intractable controversy. Without repeating these comments, the Consumer Advocate urges the Commission to avoid creation of a new regulatory adjustment mechanism using vaguely defined terms or categories, driven by cost classification criteria that are not directly retrievable from existing books and records. The RAM provision within the Joint FSOP was carefully tailored to employ readily discernable cost inputs from the Company's books and prior rate orders, using simple calculations within an annual filing that should be relatively easy to quickly audit without controversy. These characteristics are essential for efficient administration of any RAM, and to avoid the RBA/RAM process devolving to annual or quarterly contested ratemaking proceedings.

²³ CA Responses to PUC-IR-57 and CA-IR-58 filed on August 24, 2009.

E. ENERGY COST ADJUSTMENT CLAUSE AMENDMENT: WHAT ARE ITS ADVANTAGES AND DISADVANTAGES, IN TERMS OF HAWAII'S OBJECTIVES?

The ECAC employed by the HECO Companies relies upon a partial pass-through formula that holds management responsible for maintaining the thermal efficiency of generating resources through a fixed heat rate input that is established in rate cases. This process is intended to provide balanced incentives for management to invest in prudent levels of new capital investment and maintenance of its production facilities or suffer the consequences of failing to do so. If this fixed heat rate were eliminated, as initially proposed by DBEDT and HDA in this Docket,²⁴ the ECAC would become a full pass through mechanism and the HECO Companies' management could neglect its production facilities and pass along any resulting deterioration (increase) in the system heat rate to customers in the form of higher ECAC charges. Additionally, the fixed heat rate serves as a risk sharing mechanism between the utility and its ratepayers, in compliance with Act 162.²⁵

When the ECAC and its fixed heat rate were developed many years ago, implementation of a decoupling mechanism was not contemplated. The concerns about the fixed heat rate and its function in a decoupling environment were raised by HDA, HREA and DBEDT and discussed in detail in the April 20 technical workshop session

In its Final SOP dated May 11, 2009 at page 15, DBEDT recommended consideration of modifying the ECAC such that the performance incentives currently built-in to the ECAC calculation be modified or eliminated if decoupling is enacted, for the reasons stated therein. In its May 11 Final SOP, at pages 6-15, HDA explained its concerns with the ECAC and recommended that, "Some modification is necessary in order to properly decouple sales volumes from earnings"

Under HRS§ 269-16 (g)(1), automatic adjustment clauses are required to "Fairly share the risk of fuel cost changes between the public utility and its customers."

involving the parties to this Docket. These concerns are in two areas that were explained by Mr. Freedman in the panel hearings. First, changes in sales and energy production that are intended to be neutralized under decoupling may actually have an income impact due to the fixed heat rate within ECAC. Secondly, the introduction of added as-available renewable energy, as envisioned under the HCEI Agreement, may adversely impact the system heat rate with a resulting ECAC financial penalty to the HECO Companies that should not be allowed to discourage the development and interconnection of such resources.(Tr. 556-558)

The Consumer Advocate shares the concerns of the other parties that changes in energy sales that are tracked through the proposed RBA accounting and interconnection with new renewable resources should not create any incremental profits or losses to the HECO Companies due to changes in the system heat rate (relative to the ECAC fixed heat rate). To this end, heat rate analyses were performed by the HECO Companies and reviewed by the Consumer Advocate, supportive of the implementation of specific BTU per kilowatt-hour deadbands around the fixed heat rate of each utility. A discussion of the proposed deadbands and implementation details is set forth in the Joint FSOP at Exhibit C pages 10-11 and in Exhibit C, Attachment 7.26 The deadbands are designed to accommodate all reasonably anticipated changes in sales levels that would produce system heat rate impacts, with triggers for redetermination of the heat rate target and deadband under certain circumstances

Joint FSOP Exhibit C and Attachment 7 were revised and submitted for the record by the HECO Companies' letter dated June 25, 2009 to describe the final proposed treatment of the ECAC heat rate issue.

involving the addition of new resources that require a Purchased Power Agreement ("PPA").

Implementation of decoupling would reset base revenue requirement levels annually, but would not change the fixed sales heat rate. The proposed deadbands around the fixed heat rates would remain effective for the years between rate cases and would continue to provide essential cost recovery for fluctuating market prices for fuel, while providing for a narrow range of actual heat rate fluctuation for the impact of changing energy sales volumes that are decoupled. If a new renewable resource is added that requires a purchased power agreement, the fixed sales heat rate and related deadband would be studied and adjusted to recognize the new resource. The proposed ECAC heat rate deadbands and procedures for heat rate re-determination are reasonable solutions for the concerns raised by the parties. This approach creates an acceptable range for system thermal efficiency performance variations around expected levels, as may be caused by changing sales levels, without completely discarding the incentives for utility management to maintain and operate its generating resources to achieve optimal efficiency.

F. WHAT REVIEW PROCESSES AND SAFEGUARDS SHOULD THE COMMISSION CONSIDER?

In the Discussion Section of this Opening Brief, the proposed decoupling approach documented within the Joint FSOP of the Consumer Advocate and the HECO Companies was characterized as a new "regulatory framework." This characterization recognizes the profound nature of the regulatory changes that are being recommended. Tremendous uncertainties surround how decoupling will actually impact ratepayers and

shareholders in the future. The absence of any possible proof that the proposed RBA and RAM provisions will produce reasonable results in all future periods makes it essential that carefully prescribed review processes and safeguards be applied to this decoupling experiment. Reasonable filing and review processes and safeguards were written into the Joint FSOP because of these uncertainties and concerns.

1) Filing and Review Processes.

The Joint FSOP proposes an annual filing by the HECO Companies, with the content and timing of the filings set forth in detail within the RBA Provision and RAM Provision tariffs. These tariffs specify in detail how the RBA and RAM adjustments are to be quantified and the "Evaluation Procedures" specified in the RAM tariff require that, "Complete, indexed workpapers and electronic files supporting the RAM Adjustment Schedules shall be provided to the Commission, the Consumer Advocate and all parties to the Utility's most recent rate case proceeding, coincident with the date of the filing." After the filing is made with this additional workpaper documentation, the Company is obligated to "provide supplemental information" that is needed by the Commission, Consumer Advocate or any party involved with review of the filing. The Consumer Advocate and other parties may propose any adjustments that are believed necessary in connection with the filed calculations and then are to "work collaboratively" to attempt to resolve any issues that emerge. If no protest is filed by the Consumer Advocate or

See Joint FSOP Exhibit A Revenue Balancing Account ("RBA") Provision at Paragraph D and Exhibit B Rate Adjustment Mechanism Provision at "Evaluation Procedures" on page 8.

other parties, the revised RBA/RAM rates become effective "not later than 15 days after the June 1 effective date" set for in the RBA tariff.²⁸

A published notice of the annual Rate Adjustment Mechanism filing is also required, by publication in newspapers of general circulation and in customer bill inserts, within 30 days and 60 days of the Companies' filings, respectively.²⁹

The ability to correct and restate RBA/RAM adjustments does not end with the initial filings, notices and review provisions. The RBA Provision tariff provides that, "The target revenue shall be revised to correct for any errors in the calculation of the RAM Revenue Adjustment for any previous period to the extent that such errors are identified 15 days prior to the Annual implementation date specified in the RAM provision." This open-ended error correction provision enables the Commission to act upon any alleged error in RAM calculation in subsequent periods.

In the Panel Hearings, questions were raised about the possibility of major capital project costs being recovered through the RAM Provision that have not been formally reviewed or approved by the Commission. In response to this concern, the HECO Companies added clarifying language to the "Major Capital Projects Credits" section of the RAM Provision tariff to refund with interest any recoveries relating to any major capital project costs that the Commission subsequently disallows for cost recovery.³⁰

Joint FSOP Exhibit B, RAM tariff at page 8.

²⁹ Id. page 9.

The HECO Companies Letter dated July 13, 2009 addressing "Questions from Panel Hearings held on June 29 to July 1, 2009", Attachment 7 at page 4.

The Consumer Advocate believes that these filing and review procedures and the provisions for open-ended correction of errors and refunds assure that the revenue adjustments arising from decoupling can be reasonably reviewed and regulated.

2) Consumer Safeguards.

In addition to the filing and review procedures set forth immediately above, additional consumer safeguards have been specified in the Joint FSOP. These safeguards take four forms:

- An Earnings Reporting and Sharing Provision that requires each of the HECO Companies to submit a calculation of the achieved return on average common equity on a regulatory basis of accounting, with credits to customers for an increasing share of earnings above rate case-authorized ROE.³¹
- The RAM Provision tariff is subject to formal review and a showing by the
 HECO Companies that it should be continued or modified.³²
- The HECO Companies must include a summary report of its achievements and the status of certain HCEI initiatives and performance objectives, with the understanding that continuation of RAM will be influenced by the HECO Companies' performance.³³

Joint FSOP at Exhibit B, pages 4 and 5.

³² Id. page 1.

ld. page 1 and Exhibit C at VI.F.

 The RBA and RAM provisions can be rescinded by the Commission at any time, pursuant to paragraph 28 of the HCEI Agreement which states, "The Commission may unilaterally discontinue the decoupling mechanism if it finds that the public interest requires such action."

These consumer safeguards are integral parts of the Joint FSOP and provide the Commission with a continuing opportunity to monitor and correct problems with administration of the two decoupling tariffs or any inappropriate recovery of costs through the tariffs.

Any excessive earnings that may result from mis-specification of RAM inputs is self correcting in the short run through the earnings reporting and sharing provision which provides the HECO Companies a limited incentive to outperform inflation indices in the short term. Notably, the earnings sharing provision is not symmetrical, so ratepayers will be credited with a share of any above-authorized ROE that is achieved, while the HECO Companies cannot collect any additional revenues if its achieved ROE is less than authorized.

The re-opener of all RAM provisions in the next base rate proceeding can consider all relevant issues at that time, including the level of achievement of HCEI objectives and the HECO Companies' performance in such achievement, actual utility earnings performance and any continuing financial need for the extraordinary RBA and RAM ratemaking that is proposed at this time. Of course, any emergent problems with decoupling that are brought to the attention of the Commission may ultimately lead to early rescission of the mechanism at any time.

IV. CONCLUSION AND RECOMMENDATION.

The Consumer Advocate and the HECO Companies have devoted considerable time and effort to the collaborative development of the decoupling methodology and processes that are set forth in the Joint Final SOP in this Docket. The Panel Hearings raised certain concerns with details of this joint proposal that have been clarified in oral testimony or by revisions to certain of the documents attached to the Joint FSOP. The Consumer Advocate encourages the Commission to approve and implement the recommendations described herein, recognizing the importance of a new regulatory framework to the ultimate success of the initiatives memorialized in the HCEI Agreement. The decoupling plan documented in the Joint FSOP is not perfect, but it is a balanced and equitable plan that is destined to be fully documented and reviewed annually and formally in the next rate cases of the HECO Companies. Until that review occurs, earnings monitoring and sharing add comfort that only just and reasonable rates can result from the plan. Ultimately, the best test of reasonableness of the RBA and RAM will be whether these mechanisms enable the HECO Companies to maintain their financial integrity without repetitive rate case filings, while supporting achievement of the HCEI objectives at an acceptable and reasonable rate of progress. For this reason, the Commission is encouraged to approve the tariffs and other agreements memorialized in the Joint FSOP. As mention earlier, the HECO Companies informally informed the Consumer Advocate of unilateral changes to the Joint Proposal that it intended to identify and describe in the HECO Companies' opening brief. These changes were subject to further revision and the Consumer Advocate intends to review the changes discussed in the HECO Companies opening brief and discuss these changes with the

HECO Companies and the Parties and will incorporate any comments in the Consumer Advocate's reply brief.

DATED: Honolulu, Hawaii, September 8, 2009.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing DIVISION OF CONSUMER ADVOCACY'S POST-HEARING OPENING BRIEF was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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